[ONE]

# INTERNATIONAL INFLUENCE

At the dawn of the third millennium, the richer half of humanity enjoys unprecedented prosperity while the poorer half earns little more than what is needed to survive. A 45 percent share of the world's population earns less than two dollars per day, 18 percent earns less than one dollar per day, and 14 percent earns so little that they suffer from outright malnourishment.[1] It is difficult to comprehend the import of such statistics for individual human lives, but for a partial insight, consider the following account of health conditions in the Brazilian Northeast:

> There is a great deal of edema—swelling of the abdomen, limbs, and sometimes the face. The hair and skin of older children and adults can be dry and brittle. Skin infections are endemic in bodies that have virtually no resistance to scabies, impetigo, fungal infections, and all kinds of skin ulcers, invariably badly infected. Adults can live for years on end with the untreated and badly infected sores that squatters refer to as *pereba*. Seu Manoel and Terezinha, for example, both suffer from chronic skin infections on their feet and legs that have burrowed so deep that one avoids looking for fear of seeing bone.[2]

What can be done to overcome such terrible poverty in developing countries? One plausible option is to increase social welfare spending. A strong government commitment to poverty reduction, such as spending on health and education, can substantially improve living standards. Unfortunately, however, the poor do not generally mobilize effectively on their own behalf, while wealthy citizens are reluctant to pay taxes for social policies.[3] Therefore, most governments in developing countries have been unwilling or unable to substantially increase social spending.[4]

By contrast, economic growth is a goal that most citizens readily support. Moreover, growth has a powerful effect on poverty. Studies consistently show that per capita gross domestic product (GDP) explains most of the variation in living standards across nations, and for this reason nurturing economic growth is a potentially powerful solution to poverty.[5] Provisos exist: economic growth is a slow process and does not reduce poverty nearly as quickly as redistribution or social spending. Nor will economic growth reduce poverty if the fruits of this growth are overly concentrated in the hands of a few. These caveats aside, however, economic growth is nonetheless the primary way that most countries have managed to substantially reduce poverty over the long run. I therefore devote this book to a simple yet fundamental question: why do some countries achieve substantial and sustained economic growth while others do not?

Conventional wisdom has a ready answer to this question. Most economists argue that countries grow when they adopt market-friendly economic policies, such as balanced budgets and free international trade. Human capital is also important, which implies that governments should invest in education and health. Considerable controversy exists over whether industrial policy is a useful addition to this policy mix, but, that issue aside, there is considerable agreement among economists that certain economic policies facilitate economic growth.

In political science, conventional wisdom largely concurs with these policy assessments, but political scientists find these policy explanations somewhat unsatisfying. Good policy matters, but why do some countries adopt good policies while others do not? Economic policy is not determined by some philosopher-king's clear understanding of economic theory but rather by a political process. Good policy, for instance, is usually facilitated by political stability and an effective state bureaucracy. Many argue that good policy is also more likely in autonomous states that resist special-interest group demands.

There is enormous value in these insights, but conventional wisdom is overly focused on domestic policy choice and largely overlooks the profound ways that international events affect domestic economic growth. Most fundamentally, the core political and social determinants of economic growth in developing countries are not merely domestic givens but rather are heavily structured by prior experiences under colonialism. Europe heavily influenced property rights, state administrative capacity, education, life expectancy, and income distribution in most regions of the developing world. Moreover, different patterns of colonialism conditioned states and societies differently, and these colonial variations help explain why some countries succeeded while others failed.

The international arena has not only molded states and societies in the global periphery, but has also directly and immediately dictated growth outcomes through shocks. Foreign wars often devastate national economies, while foreign aid can lead to dramatic economic revival. Even more pervasively, international markets constantly and profoundly influence growth outcomes, such as the way that rising petroleum prices and interest rates drove much of the developing world into recession during the 1980s. Taken in conjunction, these external determinants of economic growth deserve a central place in contemporary scholarship.

North Americans first began to think about economic growth in developing countries in the 1950s and 1960s, when the United States suddenly found itself preeminent in the world political economy. The initial frame of reference was modernization theory, and the basic insight was that obtaining material prosperity is simply one part of becoming modern; modernity, in this context, is understood as a multidimensional process involving growing economic activity, urbanization, literacy, individualism, and political activity. This modernization approach suggested that so-called traditional societies remained poor because they had not yet modernized.[6]

This initial distinction between modern and traditional societies generated a radical reaction in U.S. and foreign scholarship in the 1970s. Dependency theorists argued that developing countries were not poor because they were traditional but rather because they had been brutalized by colonialism. European states forcibly seized control of developing countries at the periphery of the world economy and made them produce raw materials for the dynamic countries at the core. This pattern perpetuated itself after decolonization, with the nations on the periphery trapped in raw material production because they could not compete with industrial firms in core countries. The dependency perspective, in short, often suggested that poor countries are poor because international capitalism prevents them from industrializing.[7]

Dependency theory has been largely discredited in the last twenty years.[8] On the whole, the world capitalist economy seems to generate economic growth in the periphery rather than constrain growth. For instance, the regions with the greatest degree of trade integration, such as East Asia, have enjoyed a degree of success that is unprecedented in world history, with average wealth quadrupled over the last thirty years. This East Asian "miracle" proves decisively that the international system does not prohibit economic success in the periphery and most scholars, therefore, have abandoned dependency theory.

More generally, East Asian success substantially changed the terms of the development debate. Whereas modernization theorists and dependency theorists tried to understand why poor countries are poor, contemporary scholarship asks a quite different question: Why do some developing countries grow rapidly, while others grow slowly, and yet others do not grow at all? This basic question lies at the core of contemporary development studies and there is now a large body of work that provides two general competing explanations for why East Asia prospered while other regions did not.

The first is the neoliberal explanation, which emphasizes that East Asian policymakers adopted liberal policies while policymakers in other regions mistakenly intervened in markets. Neoliberals argue that East Asia grew so rapidly because the state did not restrict international trade, and did not tax and spend excessively.[9] In Africa and Latin America, by contrast, states restricted international trade, ran large budget deficits, and generally overregulated the economy. The World Bank has particularly emphasized this liberal policy explanation of economic growth.[10] The neoliberal perspective now so dominates contemporary thought that many speak of a "Washington Consensus" that developing countries should liberalize their economies.[11]

While neoliberalism has been primarily an economic perspective, political scientists have also contributed to this approach by addressing why East Asia adopted more liberal economic polices than other regions. The conventional wisdom is that East Asia was administered by strong states with extensive autonomy from societal interest groups. These states were able to ignore a range of societal demands, such as the demand for import restrictions from those hurt by free trade and the demand for more government spending from various interest groups. By contrast, Latin American states enjoyed much less autonomy from societal interest groups. Industrialists and workers gained a broad set of protectionist policies that shielded them from international trade. Social groups were also able to demand subsidies from the state, leading to chronic budget deficits. African states similarly adopted bad public policies, largely driven by the political power of urban interests or ethnic favoritism.[12]

Although neoliberalism remains the dominant perspective, increasing attention has been given to revisionist theories of development.[13] Revisionists argue that it was not free markets that caused East Asia's success but rather industrial policies. In the two most successful countries, South Korea and Taiwan, the state extensively promoted export industries through a vast array of subsidies, including cheap credit, tax breaks, reduced utility rates, technical assistance, and much more. Although revisionists have not convinced major international financial institutions that industrial policies were the primary cause of economic success, the World Bank has now conceded that state intervention did play some role in the East Asian miracle.[14]

Interestingly, although this revisionist perspective differs sharply from neoliberalism in its economic analysis, revisionist and neoliberal political analysis is actually quite similar. Like neoliberals, revisionists also emphasize the importance of state autonomy, which allows countries to single-mindedly promote industry while fending off most other demands on state resources, and permits policymakers to promote exporters and yet remain politically capable of cutting off support to inefficient firms. In addition to state autonomy, many revisionists argue that state administrative capacity was important in East Asia, allowing states to efficiently implement complicated promotional schemes.[15]

## DICTATING DEVELOPMENT

Conventional wisdom presents significant insights, yet contemporary development theory vastly underestimates the raw power of the international system in determining economic growth in the global periphery. A wide array of seemingly domestic factors, such as state structures, human capital, and sociopolitical cleavages were, in fact, largely generated by colonialism. Thus, a reconceptualization of the growth literature is needed, to account for the fact that many of the initial conditions emphasized by economists and political scientists are internationally determined. Moreover, the international system influences economic growth directly through major international shocks. Through wars, market shocks, and foreign aid, powerful nations wield considerable influence on domestic economic growth in weaker nations.

I do not attempt to determine whether these international effects, on average, were primarily positive or primarily negative in world history; but rather to establish that the international system dictated development *differently* in each country, and that these variations in external influence help explain why some countries have succeeded economically while others have not.

## EUROPEAN IMMIGRATION

Modern economic growth is a distinctly European phenomenon, and perhaps the most powerful effect that Europe has had on the global periphery has been to replicate Europe in new lands through massive immigration. Specifically, wherever Europeans settled in large numbers, they generated considerable economic success. Indeed, one can fairly accurately predict each country's relative economic performance until 1960 by simply measuring the extent to which the population in 1900 was of European descent. Where those of European descent constituted the majority of the population, namely in Australia, Argentina, Canada, New Zealand, the United States, and Uruguay, economic success was essentially guaranteed. These six nations economically outstripped all but two other countries (Israel and Venezuela) in the global periphery, and their incomes converged with those in Europe.[16]

Partial European settlement was also heavily associated with economic success. All countries in which at least one-tenth of the population was of European descent achieved an intermediate level of development by 1960, which is quite striking, given that it implies that European immigration was by itself a sufficient condition for economic progress. By contrast, only about a third of the countries without a large European population achieved intermediate levels of development. European immigration provides a remarkably powerful and parsimonious explanation of economic growth prior to 1960.

Two causal mechanisms underlie the close connection between European immigration and economic success. First, Europeans brought with them the Lockean notion that property rights are critical for economic prosperity. European settlers set up states with constitutional limits on arbitrary government action, thereby guaranteeing the population the right to own and utilize private property.[17] Modern economic theory emphasizes that property rights of this sort are an essential institutional foundation for economic growth.

In addition to securing property rights, European settlement resulted in substantial human capital, which is a critical determinant of economic growth. Europeans were generally better educated and healthier than native populations, and hence already embodied substantial human capital when they arrived in new lands. Equally important, the settlers demanded that their governments promote human capital for their children; consequently, nations with higher European settlement invested more heavily in education than other regions of the global periphery.

## COLONIAL DYSFUNCTIONS

While European immigration provides a powerful explanation of comparative economic performance in the century before 1960, it does not provide much insight into growth variation since 1960. To some extent, this is because settler states were victims of their own success. Empirically speaking, rich countries simply do not achieve spectacular economic growth, presumably due to diminishing returns on investment and because they can no longer catch up by embracing more advanced technologies from countries in the core of the world economy. By 1960, the settler states of North America and Australasia had already converged with European incomes and therefore experienced less rapid growth. The partial settler states, mostly in Latin America, were also constrained to some extent at this time by their relative prosperity, but even more important was that their initial success, in conjunction with the 1930s depression, had encouraged an autarkic development strategy that proved unviable by the early 1980s.

With the settler states largely converging on average growth rates after 1960, economic successes and failures were increasingly located in regions of the world where Europeans had not settled in large numbers.

What accounts for the variation in growth in these lands in the last four decades? In addition to domestic policy choices, the focus of conventional explanations, the relative success and failure of these economies since 1960 were also largely determined by each country's relationship with European colonialism during the previous century. Europe was both an opportunity and a threat to developing countries. Europe alone had mastered the art of sustained increase in per capita GDP, and it was clear that poor countries would need to adopt some variant of the European model if they were to obtain similar economic growth. Yet while imitating European capitalism was potentially beneficial, actual contact with European nations was often disastrous. The Europeans did not sail around the world to distribute progress, but rather to conquer, plunder, and proselytize. Whatever the economic virtues of the European model, being plundered has its costs. The trick was to somehow import European practices while avoiding two dysfunctions associated with European colonial exploitation.

The first of these dysfunctions concerned state structures. Whereas European settlers created limited states that protected property rights, European imperialists preferred extractive states that siphoned resources from the colonies. This extractive tendency endured after decolonization, and government predation discouraged private sector investment. The second colonial dysfunction concerned human capital. Whereas European settlers demanded public education for their children, European imperialists generally restricted government expenditures on colonial health and education.

There is no easy way to measure the costs of European colonialism, but it is possible to note three gradations. First, a small handful of countries avoided European colonialism, and were hence left free to imitate the European model without suffering European exploitation. Though rarely noted, this was by far the most effective route to economic success over the last forty years. Of the five countries that enjoyed the most rapid economic growth since 1960, it is quite striking that not one was a European colony.[18] Japan, Thailand, and China all escaped Europe's control and used this freedom to construct efficacious states and extensive human capital. Japan then transferred this model to Korea and Taiwan, which also enjoyed rapid growth. Not every country that enjoyed independence from Europe subsequently enjoyed rapid growth, but such independence has historically been a necessary condition for extremely rapid growth.

Among those countries that did fall under European control, one can further distinguish between early and late colonialism. Late colonialism, beginning approximately in 1885, was substantially more exploitive than its earlier forms.[19] The rapid increase in the geographic scope of colonialism led Europeans to run its territories cheaply, while simultaneously extracting whatever resources they could. Europeans therefore did not attempt to build state capacity or invest in human capital; rather, they imposed states that inhibited property rights. Partially as a result, economic performance in countries colonized after 1885 has been worse than countries colonized before 1885.

## INTERNATIONAL SHOCKS AND FOREIGN AID

European immigration and European exploitation set the broad patterns of development over the last few hundred years. International actors had still further effects, however, through wars, markets, and foreign aid. Since World War II, foreigners have waged war in and on Angola, Afghanistan, Iraq, Nicaragua, and Vietnam—just to mention the more dramatic examples—and each of these foreign wars had a devastating impact on economic production.

Foreign countries also influence growth in the periphery through international markets. An excellent example is the worldwide economic crisis that began around 1980. Rising interest rates in North America, along with rising world petroleum prices, created a global recession. This recession was exacerbated by international banks' decisions to end the large-scale capital flows going to developing countries in the 1970s. Together, these negative shocks generated a "lost decade" in the 1980s, during which most of the developing world was thrown into prolonged stagnation.

Finally, foreign countries influence growth through foreign aid. Korea's economic miracle, for instance, was initially financed by U.S. aid. More recently, Mozambique has turned its long debacle into a minor miracle, with total GDP roughly doubling in the last decade. This, too, was largely underwritten by foreign aid. Aid is certainly no panacea, but it is nonetheless a powerful mechanism through which the developed world influences developing countries.

I do not mean to imply that economic growth in the developing world is solely determined by international factors. Citizens in developing countries wield enormous control over their own fates, and domestic choices clearly matter. Nonetheless, it is important to note that the international system plays an equally profound role in dictating development. Certainly, some attention has been paid to the international dimension in recent decades.[20] Dependency theory, although currently discredited, pioneered an international approach to development. More recently, a portion of the economic adjustment literature has emphasized that international market shocks help explain neoliberal policy choice in the 1980s and 1990s. However, most contemporary scholars seeking to explain variations in economic growth give scant attention to the international dimension. Just as *dependentistas* erred in the 1970s by underestimating domestic contexts, contemporary accounts underestimate the international context.